

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: IOWA TELECOMMUNICATIONS SERVICES, INC., d/b/a IOWA TELECOM	DOCKET NO. INU-01-1
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ORDER DENYING PETITION FOR RECONSIDERATION

(Issued May 24, 2002)

PROCEDURAL HISTORY

On August 9, 2001, Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom (Iowa Telecom), filed a petition for deregulation of its retail local exchange services in nine exchanges where Iowa Telecom alleged it was subject to effective competition. The petition was filed pursuant to Iowa Code § 476.1D (2001). The Utilities Board (Board) docketed the petition as a formal notice and comment proceeding and received initial and reply statements from a number of interested persons. A hearing was held on December 11, 2001, briefs and reply briefs were filed, and on April 5, 2002, the Board issued its "Order Denying Petition For Deregulation" (the Final Order).

On April 25, 2002, Iowa Telecom filed a petition for reconsideration of the Final Order. On May 9, 2002, the Iowa Association of Municipal Utilities (IAMU), Coon Rapids Municipal Communications Utility and Manning Municipal Communication and Television System Utility (Coon Rapids and Manning), and the

Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed answers or resistances to the Iowa Telecom petition for reconsideration. On May 10, 2002, another resistance was filed by Independent Networks, L.C., Farmers' and Business Mens' Telephone Company, Forest City Telecom, Inc., Lost Nation-Elwood Telephone Company, and Clarence Telephone Company (collectively, the Independent Group).

The first question is whether reconsideration is available in this docket. The Board has previously ruled that deregulation dockets are not contested cases, see Re: U S WEST Communications, Inc., Docket No. INU-99-3, "Order Denying Reconsideration" (issued April 20, 2000), but in that case the Board also found that there was no reason not to apply the normal rehearing procedures and consider the application for reconsideration. The Board will follow the same procedure in this docket.

SUMMARY OF FILINGS

Iowa Telecom Petition

Iowa Telecom argues the evidence in this proceeding supports a finding that the competitive market forces in the identified exchanges are sufficient to assure just and reasonable rates without regulation. Iowa Telecom notes there are two viable providers in each of the exchanges and that Iowa Telecom's market share in these exchanges has been reduced by up to 95 percent. Iowa Telecom argues that the Board recognized the relevance of market share data in its "Order Denying

Petition To Deregulate" issued March 1, 2000, in Re: U S WEST Communications, Inc., Docket No. INU-99-3, but appears to have rejected consideration of market share evidence in this proceeding. Iowa Telecom appears to be arguing that the Board should follow its decision in U S WEST, as interpreted by Iowa Telecom.

Next, Iowa Telecom argues that the evidence supports a finding that it would lack the ability to control prices in the identified exchanges if it is deregulated. Again, Iowa Telecom compares this case to the Board's decision in the U S WEST case, where the Board found that U S WEST's continued high market share, even with higher rates, was evidence that U S WEST had some ability to control prices despite the existence of facilities-based competition. Iowa Telecom argues this finding recognized the relationship between prices and market share, requiring consideration of the market share evidence in the record.

Finally, Iowa Telecom argues that the evidence supports a finding that other providers are able and likely to enter the identified exchanges. Iowa Telecom asserts the Board has misinterpreted 199 IAC 5.6(1)"b," which requires consideration of the relative ease of entry, to require instead a showing that it is actually "easy" to enter the market. Iowa Telecom argues the evidence establishes that two facilities-based providers are all that can be expected in a rural exchange, so the existence of two such providers should be sufficient to permit deregulation of these exchanges, in the interests of competitive fairness.

IAMU Resistance

IAMU argues Iowa Telecom's loss of market share in these exchanges may have other causes than competition, specifically referring to the service quality problems of Iowa Telecom's predecessor. IAMU argues Iowa Telecom may be able to correct its service quality problems and regain substantial market share, so it cannot be said that the existing levels of competition will continue after deregulation.

IAMU also argues that the testimony of the Iowa Telecom witness that the company would not engage in predatory pricing if it is deregulated is of no probative value, since the same witness also testified that (a) he did not rely on any specific definition of predatory pricing and (b) he did not have any particular understanding of the issue. (Tr. 39-40.) IAMU asserts that, in any event, this testimony misses the point, which is whether Iowa Telecom will have the ability to engage in predatory pricing if deregulated, regardless of whether it currently intends to exercise that ability.

Coon Rapids and Manning join in the IAMU resistance.

Consumer Advocate Answer

Consumer Advocate's answer begins with a discussion regarding the nature of these proceedings and then points out that the basis of the Board's decision in this docket is not limited to the reasons described in Iowa Telecom's petition for reconsideration. Instead, the Board's decision reflects consideration of, and

reliance upon, expert testimony and other evidence that Iowa Telecom does not address in its petition. For example, Consumer Advocate notes that Iowa Telecom offered no evidence that the existing duopolies represent effective competition, while substantial expert testimony to the opposite effect was offered by other parties (including Consumer Advocate).

Consumer Advocate argues that the Board's decision in this docket is consistent with the U S WEST decision regarding the incumbent's ability to control prices. In the U S WEST case, the Board found that U S WEST's ability to retain significant market share while charging higher prices was evidence that the market was not responding to price signals in the manner that might be expected of a competitive market. The same general observation is true in this docket; Iowa Telecom was losing market share in each of these exchanges and still chose to raise its rates by the maximum amount permitted under its price regulation plan, the opposite of what one might expect as a competitive response to loss of market share. This failure of an alleged competitor to respond appropriately to market price signals is evidence of the carrier's ability to control prices, that is, evidence that the carrier is not following the market.

Consumer Advocate argues that Iowa Telecom's concern regarding the interpretation of the "ease of entry" factor is misplaced, as nothing in the Board's decision supports the claim that the Board has confused "ease of entry" with "easy entry." Consumer Advocate argues the Board properly focused on the question of

whether additional providers are likely to enter these exchanges after deregulation, a relevant consideration when deciding whether these exchanges are subject to effective competition.

Independent Group Resistance

The Independent Group asserts that Iowa Telecom's allegation of inconsistency between the Board's decision in this docket and its decision in U S WEST relies upon a logical error. According to the Independent Group, in the U S WEST decision the Board found that duopoly may be found to be effective competition in some future case (although it was not sufficient in U S WEST), but the Board did not find that a duopoly will always be effective competition. This finding is consistent with the Board's ruling in this case, where Iowa Telecom was given the opportunity to show that the existing duopolies amounted to effective competition, but did not offer sufficient credible evidence in support of its position.

With regard to the Board's finding that Iowa Telecom failed to prove it could not control prices in the identified exchanges, the Independent Group argues Iowa Telecom is attempting to shift the burden of proof. Iowa Telecom's argument would require the other parties to prove that Iowa Telecom would be able to control prices after deregulation, an inappropriate allocation of the burden. Instead, the Board's order properly put the burden on Iowa Telecom to show that it would be unlikely that Iowa Telecom could control prices after deregulation, as required by 199 IAC 5.6(1)"a."

As to the issue of ease and likelihood of entry, the Independent Group notes that Iowa Telecom's own witness agreed that other entrants are not likely to enter these exchanges. (Tr. 167-68.) Thus, Iowa Telecom's own testimony establishes that the likelihood of entry by any additional service providers is very low.

ANALYSIS

The Board will deny Iowa Telecom's petition for reconsideration of the Final Order, as it does not contain any new evidence or argument that persuades the Board to change its decision. Iowa Telecom relies upon selected parts of the record in order to re-argue its case, but the company ignores conflicting evidence and argument the Board has already found more persuasive.

1. Are Market Forces Sufficient To Assure Just And Reasonable Rates?

Iowa Code § 476.1D requires deregulation of communications services if the Board finds the services are "subject to effective competition." One factor the Board must consider in making that decision is "whether market forces are sufficient to assure just and reasonable rates without regulation."

Iowa Telecom claims that the existence of a single facilities-based competitor in each exchange should be considered sufficient competition to assure that rates in those exchanges will continue to be just and reasonable without regulation. However, Iowa Telecom's argument ignores substantial evidence from the Consumer Advocate witness that the resulting duopoly will not provide effective

competition in these circumstances. As the Board stated in its final decision and order in this docket:

As shown in Revised Confidential Exhibit B, only one alternative wireline provider exists in each of the nine exchanges under consideration. Iowa Telecom argues that the duopoly in each of the nine exchanges is sufficient for a finding of effective competition. Consumer Advocate, RIITA, and the Municipal Group disagree arguing that the market concentration of a duopoly does not assure just and reasonable rates. Other parties argue that Iowa Telecom failed to adequately address the question of effective competition. One of Iowa Telecom's witnesses admits that no economist was used in preparing Iowa Telecom's statement or counterstatement, nor were there any surveys of customers to identify why they had lost market share. (Tr. 36.)

In this record, there is no economist who testifies that effective competition exists in a duopoly situation. A number of measures of market share and market power exist to try to measure the likelihood that such market forces exist and will endure. In the past, the Board has declined to rely heavily on economic measures of competition such as the Herfindahl-Hirschman Index (HHI) for determining the existence of effective competition. (U S WEST Communications, Inc., "Order Denying Petition for Deregulation," Docket No. INU-99-3, 15.) The Board found that reliance on the HHI would have the "practical effect of nullifying Iowa Code § 476.1D by imposing a standard that is never likely to be met." The Board continues to believe that excessive reliance on tests that were formulated for other purposes may have the undesirable effect of nullifying the statute and should therefore be viewed with caution, if they are to be considered at all.

Even if the Board is persuaded that an economist's definition of effective competition is too restrictive and a pragmatic acceptance of duopoly is warranted on other bases, however, the Board is still concerned about the future viability of a duopoly as a form of effective competition. If a

large company has the freedom to target isolated markets in turn and drive local competitors out of business, then the market forces of a duopoly are unlikely to be adequate to maintain the duopoly and assure reasonable, competitive rates. In other words, complete deregulation may allow predatory behavior that can, and possibly will, destroy the nascent market being used as rationale to justify deregulation. Moreover, if an entity with predatory pricing power drives the competition out of business, re-regulation does not offer an adequate solution. In such a scenario, Iowa Telecom gets all its customers back and the CLEC is gone with little likelihood or incentive to ever come back. That is not consistent with the legislative intent behind Section 476.1D.

(Final Order at pages 12-13.)

Iowa Telecom's petition for reconsideration ignores substantial evidence from the other parties regarding Iowa Telecom's ability to engage in predatory pricing after deregulation and the effect that would have on its current and potential competitors. The Board considered all the evidence, including Iowa Telecom's market share evidence in Revised Confidential Exhibit B, and concluded Iowa Telecom had not proven the existence of effective competition; nothing in the petition for reconsideration changes that conclusion.

2. Does A Single Provider Have The Ability To Control Prices?

In addition to the statutory factors the Board must consider under § 476.1D, the Board has adopted rules specifying other factors that may be considered. One such factor is the ability or inability of a single provider to determine or control prices in a deregulated market, see 199 IAC 5.6(1)"a." Iowa Telecom claims that the fact that it has lower prices in some exchanges and still lost market share is

evidence that it lacks the ability to control prices in those exchanges, citing the Board's final decision in U S WEST. Again, Iowa Telecom ignores the record evidence that supports the contrary finding. For example, when Iowa Telecom lost market share in those exchanges where its prices were lower, the company nonetheless chose to raise its rates by the maximum amount permitted by law, the opposite of the response expected in a competitive market. Iowa Telecom's actions are evidence that its pricing decisions are controlled by factors other than competition, that is, that Iowa Telecom has at least some ability to control its prices in these exchanges.

In the end, the record as a whole does not support a finding that Iowa Telecom would lack the ability to control its prices in these exchanges after deregulation. As the Board said in its order denying the petition for deregulation,

Little or no convincing evidence has been presented to show that Iowa Telecom would not have ability to set its own prices at almost any level in deregulated exchanges. The record shows that Iowa Telecom has lower prices and less market share than a competitor in some of the regulated exchanges, but this is not evidence that Iowa Telecom cannot and will not control prices if deregulated. If the Board deregulates retail services in the nine exchanges, two possibilities may result: Price predation and duopolistic pricing. Iowa Telecom may choose to target an exchange to acquire a larger market share or to drive a smaller, shallow-pocketed competitor out of business. Or, duopolistic pricing may evolve, leaving the customer with no real choices. In either case, Iowa Telecom has the ability to control prices and, accordingly, the direction of the market.

(Final Order at pp. 15-16.)

3. What is the Likelihood That Other Providers Will Enter the Market?

Two more of the factors specified in the Board's rules can be considered together: The ease with which other providers may enter the market and the likelihood that will happen. 199 IAC 5.6(1)"b" and "c." Iowa Telecom argues it has proven that other providers are able and likely to enter the market after deregulation because some of the record evidence shows the following:

1. There is one other facilities-based provider in each exchange;
2. Each of those providers entered under normal circumstances;
3. Other providers have obtained the necessary regulatory approvals to allow them to enter the markets; and
4. Resale, UNEs, and facilities-based service would all be available to any new market entrants.

If the Board were to accept this evidence as sufficient regarding this factor, then the factor would become almost meaningless. For practical purposes, any ILEC with a single facilities-based competitor would be able to meet this test. The Board will not set this requirement so low.

The Board emphasizes that it has not confused "ease of entry" with "easy entry," as alleged by Iowa Telecom. Instead, the Board properly considered the likelihood that other providers will enter an allegedly competitive market after deregulation, since new and potential entrants may represent additional market forces that would tend to keep rates reasonable without regulation. Here, Iowa Telecom's own testimony establishes that it is very unlikely there will be any new

entrants in any of these exchanges. (Tr. 167-68.) Iowa Telecom cannot reasonably claim the record evidence supports a finding that this factor has been met.

CONCLUSION

The Board will deny Iowa Telecom's petition for reconsideration. The petition relies upon selected evidence from the record to make its case, ignoring contrary evidence that the Board found more persuasive.

ORDERING CLAUSE

IT IS THEREFORE ORDERED:

The petition for reconsideration filed by Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom, on April 25, 2002, is denied.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 24th day of May, 2002.